

EX PARTE OR LATE FILED

**BELLSOUTH**

W. W. (Whit) Jordan  
Director-Federal Regulatory

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EX PARTE

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APR 14 1993

April 14, 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Ms. Donna A. Searcy  
Secretary  
1919 "M" Street N.W., Room 222  
Washington, D.C. 20554

RE: CC Docket 92-24

Dear Ms. Searcy:

Today, the attached letter was delivered by hand to  
Gregory J. Vogt, Chief, Tariff Division in connection with  
CC Docket No. 92-24.

Please call me if you have any questions.

Sincerely,

WW Jordan

# BELLSOUTH

W. W. (Whk) Jordan  
Director-Federal Regulatory

Suite 900  
1133-21st Street, N.W.  
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Mr. Gregory J. Vogt  
Chief, Tariff Division  
Federal Communications Commission  
1919 M Street, N.W., Room 518  
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

RE: CC Docket No. 92-24

Dear Mr. Vogt:

This letter further explains BellSouth's methodology for developing overhead ratios for new service tariff filings, clearly demonstrating that LIDB rates recover a reasonable amount of overhead costs; provides additional evidence showing that the use of ARMIS data to calculate direct cost ratios is inappropriate; and provides for the record prices for calling card/credit card validation rates which support BellSouth's rate of \$.042 as being reasonable.

First, the following explains BellSouth's overhead ratio development used to support the introduction of new services under price caps. The aggregated interstate recurring revenue for the access service category in which the new service will ultimately reside is calculated by multiplying the billed demand quantities by the corresponding rates. The aggregated interstate recurring cost for the service category is estimated by multiplying the BellSouth billed demand quantities by the incremental unit costs. The aggregated revenue is then divided by the aggregated cost to yield the revenue to cost ratio. This overhead ratio is used for new service tariff filings.

Prior to price caps the rate development methodology used by BellSouth also relied on unit costs. Embedded unit costs were developed using company records. These unit costs were multiplied by the test period demand, and the products summed to a total embedded cost for each category. The total embedded costs were then divided into the total tops down revenue requirement by category developed by the separations process. The resulting "closure factors" were applied to each rate element's embedded cost to determine the price. Closure factors

were applied to take into account common cost loadings at the rate element level that are reflected in revenue requirements. The embedded costs were only used as an allocator for each category specific revenue requirement.

The initial price cap rates had as a basis rates that were developed using the closure factor process. These rates were equal to the revenue requirement, and as such were determined appropriate for use in BellSouth's overhead ratio development. Incremental costs have been substituted for embedded costs because of their economic foundation. Incremental costs establish a economically rational price floor. The ratio of the incremental costs for a service category to that category's existing revenue, forms the overhead ratio as discussed in the second paragraph above. This simple test compares the existing markup over incremental costs to the proposed markup of the new service. If the markup for the new service does not exceed the existing markup for the category, BellSouth has demonstrated that its pricing is rational and that the new element is not bearing an unreasonable level of loading. As time goes on and as prices change due to price caps, the markup ceiling will continue to be compared to the new service's incremental costs, which will also change with time. This assures consistency of pricing application. Attachment 1 provides a comparison of the closure factor under rate of return to the overhead ratio used for price cap filings. As can be seen from this comparison, the rate of return closure factor (3.5) and the price cap overhead ratio (3.33) are comparable. Moreover, the overhead ratio for LIDB (3.00) is reasonable in comparison to both the rate of return closure factor and the price cap overhead ratio.

The unit costs used in developing BellSouth's current overhead ratios for each service category are developed using consistent incremental costing methodologies. Attachment 2 provides additional details on how these costs are developed.

Attachment 3 displays the wide variation in the investment distribution among COE, IOT, CWF, and GSF for the ARMIS Transport data and the LIDB rate elements. These data clearly show that an ARMIS direct cost ratio is based on too broad of an average plant account mix and is not appropriate for application to incremental investments. The specific LIDB rate elements have very different plant account mixes. For example, the ARMIS data shows Transport with 64% of its investment as COE, whereas the LIDB STP Port, Common Transport, and Validation rate elements show COE investment levels of 100%, 96%, and 95%, respectively.

Not only does the account mix make the ARMIS direct cost ratio inappropriate for application to incremental investments, the varying levels of noninvestment related direct costs such as service specific software right-to-use fees are not reflected in the ARMIS data. Paragraph 3 of BellSouth's 3/19/93 Ex Parte letter provides clear examples of this effect.

Attachment 4 shows prices for calling card/credit card validation charged by other parties which are comparable to BellSouth's \$.042. These comparable rates validate the reasonableness of BellSouth's charge.

As discussed above, BellSouth's overhead ratio development methodology is similar to the closure factor methodology used prior to price caps and is a natural evolution. The unit cost studies used are prepared using consistent incremental costing methodologies. The demand used in calculating the revenues and total incremental costs is identical.

If you have questions, do not hesitate to call.

Sincerely,

A handwritten signature in cursive script that reads "Whit Jordan".

Whit Jordan  
Director-Federal Regulatory

Attachments

Attachment 1

**COMPARISON OF CLOSURE FACTOR-RATE OF RETURN FILING  
TO OVERHEAD RATIO - PRICE CAP FILING**

**1990 ANNUAL TARIFF FILING (RATE OF RETURN)**

|   |               |
|---|---------------|
| Local Transport Revenue Requirement                             | \$508,648,749 |
| Local Transport Nonrecurring Revenue                            | \$ 14,582,542 |
| Local Transport Recurring Revenue Requirement                   | \$494,066,207 |
| Local Transport Cost Requirement (Smoothed)                     | \$196,519,417 |
| Revenue Requirement - Cost Requirement Adjustment<br>(Smoothed) | 2.51          |
| Local Transport Cost Requirement                                | \$141,066,207 |
| Revenue Requirement - Cost Requirement Adjustment               | 3.50          |

**1992 ANNUAL TARIFF FILING (PRICE CAPS)**

|                                   |               |
|-----------------------------------|---------------|
| Local Transport Recurring Revenue | \$429,648,723 |
| Local Transport Recurring Cost    | \$129,032,994 |
| Revenue - Cost Ratio              | 3.33          |

**LIDB TARIFF FILING**

|                    |             |
|--------------------|-------------|
| LIDB Revenue       | \$9,547,714 |
| LIDB Cost          | \$3,181,379 |
| Revenue-Cost Ratio | 3.00        |

INCREMENTAL COST DEVELOPMENT DESCRIPTION

Switched Access - Transport

In order to develop usage costs for Local Transport it is necessary to first simulate BellSouth's public switched network. A sample of point-to-point usage records is extracted from the total universe of usage records in order to keep the quantity of study data to a manageable level. Using these usage records and company trunking, circuit equipment and central office switch records, a network database is populated. Unit investments are developed for the forward looking trunking, circuit equipment, and tandem switching technologies to be employed in the study. Forward looking investments are used because it is future resources that are affected by pricing decisions. To develop incremental usage costs, a stimulation factor is applied to the usage sample to produce an incremental amount of usage. Using the network database and trunking tables (e.g., Neal-Wilkinson) the additional facilities required to transport the incremental usage are calculated. The forward looking unit investments discussed earlier are applied to the quantities of incremental facilities to determine the incremental investment associated with the incremental usage. The incremental investment is then divided by the incremental usage (annual originating plus terminating access minutes of use) to produce Local Transport incremental investment per access minute of use. Annual cost factors are applied to these incremental unit investments to derive the forward looking long run incremental annual cost per access minute of use associated with Switched Access Local Transport.

Switched Access - Local Switching

BellSouth develops Local Switching costs per minute of use utilizing Feature Group specific switching investment.

minutes to produce the total BH investment by feature group. Annual cost factors are applied to the investment for each feature group to produce annual costs. The annual costs for Feature Groups A and B are added together and divided by the sum of Originating plus Terminating annual access minutes of use for the two feature groups to produce the LS1 cost per access minute of use. The same process is used for Feature Groups C and D to derive the LS2 cost per access minute of use.

### Special Access

Special Access rate elements consist primarily of local channels, interoffice channels (fixed and per mile) and channel terminations. The steps in an incremental cost study for each element are as follows.

Step 1: Develop standardized engineering designs for the element, such as loop, interoffice circuit, etc., using forward looking technology based on BellSouth Network Deployment Guidelines.

Step 2: Specify each network component required to provision the element.

Step 3: Determine current installed forward looking investment of each network component.

Step 4: Apply utilization factors and loadings factors for common support, such as land, buildings, poles, conduit and miscellaneous common equipment and power.

Step 5: Compute annual cost by applying account specific annual cost factors and convert to monthly cost by dividing by 12.

Step 6: Weight the cost of each design by its probability of occurrence to determine one cost for the rate element.

The Local Switching and Transport unit cost studies used in developing the aggregated incremental costs have not been used to support new service tariff filings. Certain Special Access local channels, interoffice channels, and channel terminations unit costs that were used in developing the aggregated incremental costs have been used in the Contract Service Payment Plan for DS1 High Capacity and Digital Data Access Service (DDAS), FlexServ(Registered Trademark), and MUX Restructure new service filings.

**Attachment 3**

## COMPARISON OF ARMIS TRANSPORT AND LIDB INVESTMENT DISTRIBUTIONS

|                            | <u>% Investment Distribution</u> |            |            |            |
|----------------------------|----------------------------------|------------|------------|------------|
|                            | <u>COE</u>                       | <u>IOT</u> | <u>CWF</u> | <u>GSF</u> |
| ARMIS - Transport Category | 64                               | 0          | 18         | 19         |

## LIDB RATE ELEMENTS



Attachment 4

CALLING CARD/CREDIT CARD VALIDATION CHARGES PER QUERY

|                  |            |
|------------------|------------|
| BellSouth        | \$ .042    |
| ITN              | \$ .046    |
| Visa/Master Card | \$ .05-.06 |